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IN THE

Supreme Court of the United States.

OCTOBER TERM, 1931.

No. 560.

CONTINENTAL TIE AND LUMBER COMPANY,
PETITIONER,

v.

THE UNITED STATES.

Brief in Support of Petition for Writ of Certiorari.

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OCTOBER TERM, 1931.

No. 560.

CONTINENTAL TIE AND LUMBER COMPANY, *Petitioner*,

v.

THE UNITED STATES.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I. THE OPINION OF THE COURT BELOW.

The opinion of the Court of Claims was handed down on October 20th, 1931. It is not yet reported but appears at page 15 of the record. The judgment of the Court was entered on October 20th, 1931, and appears at page 21 of the record.

II. JURISDICTION.

The jurisdiction of this Court is invoked under Section 240 of the Judicial Code as amended by the Act of February 13th, 1925 (U. S. C., Title 28, Sec. 288), and under Section 1003 of the Revenue Act of 1926 (U. S. C., Title 26, Sec. 1226).

The Court of Claims held that a payment of $25,228.35 received by the Cimarron and Northwestern Railway Company on October 19th, 1923, pursuant to the provisions of Section 204 of the Transportation Act of 1920 (41 Stat. 456, 460), constituted taxable income to said Company in the year 1920 and should be included in computing the consolidated net income of said Company and petitioner for said year.

In so holding the Court of Claims decided an important

question of Federal law, contrary to the applicable decisions, of this Honorable Court,

Eisner v. *Macomber*, 40 S. Ct. 189, 252 U. S. 189,
Edwards v. *Cuba R. R. Co.*, 45 S. Ct. 614, 268 U. S. 628;

contrary to the holding upon the same issue by the Interstate Commerce Commission, which agency was charged with the interpretation and administration of the Transportation Act of 1920 (I. C. C. Finance Docket No. 1176); and contrary to the fundamental principle of income taxation, namely, that income can arise only through contract.

Furthermore, the decision of the Court of Claims in this case is of widespread interest because of the many cases involving the same question now pending before the Bureau of Internal Revenue, the United States Board of Tax Appeals, and the Courts.

III. STATEMENT OF THE CASE.

A full statement of the case appears under the heading "A" of the Petition and in the interest of brevity it is not repeated here.

IV. THE LAW INVOLVED.

The statutory provisions involved are set out in the appendix hereto, consisting of excerpts from the Revenue Act of 1918 and the Transportation Act of 1920.

V. SPECIFICATIONS OF ERROR.

1. The Court of Claims erred in finding and holding that the payment in 1923 of $25,228.35 to the Cimarron and Northwestern Railway Company, under the provisions of Section 204 of the Transportation Act of 1920, constituted taxable income to said Company.

2. The Court of Claims erred in finding and holding that the payment of $25,228.35 to the Cimarron and Northwestern Railway Company in 1923 under the provisions of Section 204 of the Transportation Act of 1920, even though taxable, constituted income in 1920.

3. The Court of Claims erred in entering judgment for petitioner only in the amount of $200.00, when it should have given judgment also for $2,522.84, representing the tax paid on the item of $25,228.35 here in controversy.

ARGUMENT.

The question here is as to the taxability in 1920 of a payment made to the Cimarron and Northwestern Railway Company in 1923 of $25,228.35, under the provisions of Section 204 of the Transportation Act of 1920.

The Cimarron and Northwestern Railway Company was affiliated with petitioner throughout 1920 within the purview of Section 240 of the Revenue Act of 1918, and the two companies rendered a consolidated income tax return for that year. The two companies kept books and rendered returns on the accrual basis. (See Finding 5 of the Court, R. 15.)

Section 213 (a) of the Revenue Act of 1918 (set out in full in the appendix), provides that all gains and profits of a taxpayer shall be included in gross income. Invoking the authority of this section the Commissioner of Internal Revenue included in 1920 income the item of $25,228.35 here in dispute.

Section 213 (b) (3) of the Revenue Act of 1918 (see appendix) provides that the value of property acquired by gift shall be excluded from gross income. Under the provisions of this section petitioner contends that the item of $25,228.35 should be excluded from gross income.

The argument then resolves itself into two questions:

First. Did the payment to the Cimarron and Northwestern Railway Company under the provisions of Section 204 of the Transportation Act of 1920 constitute gains or profits to it?

Second. If it did, was that gain or profit taxable in 1920 or in 1923 when it was determined and paid?

These questions form the basis of the following argument:

1. Payments under Section 204 of the Transportation Act of 1920 do not constitute taxable income.

The question of what constitutes taxable income has been before this Honorable Court a number of times. In *Eisner* v. *Macomber*, 40 S. Ct. 189; 252 U. S. 189, a case arising under the Revenue Act of 1916, this Court said:

> "(6) After examining dictionaries in common use (Bouv. L. D.; Standard Dict.; Webster's Internat. Dict.; Century Dict.), we find little to add to the succinct definition adopted in two cases arising under the Corporation Tax Act of 1909 (Stratton's Independence *v.* Howbert, 231 U. S. 399, 415, 34 Sup. Ct. 136, 140 [58 L. Ed. 285]; Doyle *v.* Mitchell Bros. Co., 247 U. S. 179, 185, 38 Sup. Ct. 467, 469 [62 L. Ed. 1054]), 'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets, to which it was applied in the Doyle Case, 247 U. S. 183, 185, 38 Sup. Ct. 467, 469 (62 L. Ed. 1054). * * *
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> * * * * * * * *
>
> "The government, although basing its argument upon the definition as quoted, placed chief emphasis upon the word 'gain,' which was extended to include a variety of meanings; while the significance of the next three words was either overlooked or misconceived. '*Derived—from—capital*'; '*the gain—derived—from—capital*,' *etc.*"

Nothing has been added to or taken from this definition of income since it was promulgated in 1919.

Obviously the payment under Section 204 was not derived from capital or labor of the Cimarron and Northwestern Railway Company and was not derived from the sale of any of its capital assets. *It therefore does not fall within the definition of income as stated by this Honorable Court.*

The payment under Section 204 was not a payment of any obligation due to the Cimarron and Northwestern Railway Company from the United States. The payment of $2,000.00 on June 28th, 1923, by the Director-General of Railroads

was settlement in full of all claims arising out of federal control and constituted the final settlement between the Director-General and the Cimarron and Northwestern Railway Company. (See first paragraph of Finding 4 of the Court of Claims, R. 12.) On October 13, 1923, after said final settlement was made, the Interstate Commerce Commission determined that $25,228.35 was due the Cimarron and Northwestern Railway Company under Section 204 of the Transportation Act and thereupon certified that amount to the Secretary of the Treasury for payment. *Thus the payment in question was not the fulfillment of any obligation on the part of the Government.* It was nothing more than a bounty or subsidy which Congress saw fit to give and, therefore, *a gift* to be excluded from income under Section 213.(b) (3) of the Revenue Act of 1918. (See appendix.)

The Transportation Act of 1920 provided for the turning back of the railroads to the carriers and for settlement of all differences and compensation due. It is interesting to note that the payment therein provided to be made to the trunk line railroads which were turned back at that time under Section 209 of the Act is referred to as a guaranty, while in Section 204 of the Act, which deals with short line railroads not then under Federal Control, *Congress studiously avoided using the term guaranty or any term implying compensation.*

It is patent that "income" as defined by this Honorable Court arises only through contract, express or implied. In Finance Docket No. 1176 the Interstate Commerce Commission, having under consideration the provisions of Section 209 of the Transportation Act of 1920, said:

> "The guaranty under section 209 is wholly independent of any damages which the carriers may have suffered by reason of the temporary taking of their property during the period of federal control. For all such damages the government must render just compensation; and by their acceptance of the provisions of section 209 the carriers have in no way surrendered or abated any claims arising out of federal operation. The guaranty, therefore, *was not founded upon a legal obligation*, but upon the thought that in fairness it was the duty of the government to protect the income of the carriers, following

> the termination of federal control, until such time as higher rates could be made effective under the provisions of section 15a of the interstate commerce act." (Italics supplied.)

The Interstate Commerce Commission is the governmental agency which has construed and applied the Transportation Act of 1920. All of its dealings and settlements with the railroads and all accounting matters since July 12, 1921, the date of that decision, have been made in the light of the above quoted interpretation and holding. *Then, if the guaranty payments made to the trunk line railroads under section 209 were "not founded upon a legal obligation" of the Government, and therefore not income, how much more true would this be of the payments made under Section 204 to short line railroads which had previously been relinquished from Federal control and with whom settlements in full had been made.*

In *Edwards* v. *Cuba Railroad Company*, 45 Sup. Ct. 614, 268 U. S. 628, this Honorable Court held that subsidies paid to the railroad by the Cuban Government did not constitute taxable income within the meaning of the 16th Amendment to the Constitution, even though the railroad had to comply with certain definite requirements in order to receive the subsidies, among which was the building of additional lines into new territory. In its opinion the Court, among other things, said:

> "The subsidy payments taxed were not made for services rendered or to be rendered. They were not profits or gains from the use or operation of the railroad, and do not constitute income within the meaning of the Sixteenth Amendment. See Stratton's Independence *v.* Howbert, 231 U. S. 399, 415, 34 S. Ct. 136, 58 L. Ed. 285; Eisner *v.* Macomber, 252 U. S. 189, 207, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570; Merchants' Loan & Trust Co. *v.* Smietanka, supra."

In the Cuba Railroad case the railroad was required to do certain things and construct certain lines in addition to operating its railroad. In the instant case the railroad was not

required to do anything in order to be entitled to the payment other than to operate its road during the 6 months following February 29th, 1920,—a thing it would have done irrespective of the provisions of Section 204 of the Transportation Act. If the subsidies paid by the Cuban Government were not for services and were not profit or gain from the use or operation of the railroad, how much more true is it that the payments made to short line railroads by the United States under Section 204 of the Transportation Act of 1920 did not constitute "income."

Section 204 placed no obligation on the railroads. The obligation was on the Interstate Commerce Commission to ascertain and certify to the Secretary of the Treasury the amounts to be paid and on the Secretary of the Treasury to pay such amounts as were certified. If these payments had been obligations, the government would doubtless have hastened settlement and payment. On March 4, 1927, Congress amended Section 204 by adding thereto a new paragraph reading as follows:

> "(h) This section shall not be applicable to any carrier which has not, on or before the expiration of sixty days after this subdivision takes effect, filed with the commission a statement, compiled substantially in the manner prescribed in this section, showing the amount claimed to be due such carrier under this section." (U. S. C. Title 49, Sec. 73 (h) .)

Thus the only requirement imposed on the short line railroads was imposed in 1927, after petitioner and most of the other railroads had been paid. This amendment discloses an intent on the part of Congress not to fulfill an obligation of the Government but to fix a time when its generosity should cease.

Wherefore, it is submitted that the payment of $25,228.35 to the Cimarron and Northwestern Railway Company in 1923, under the provisions of Section 204 of the Transportation Act of 1920, did not constitute taxable income to it.

2. Even if it should be held that the payment to the Cimarron and Northwestern Railway Company in 1923 constituted taxable income under Section 204 of the Transportation Act of 1920, it was not income within the year 1920.

The determination of the amount payable under Section 204 of the Transportation Act of 1920 was an administrative act imposed by Congress on the Interstate Commerce Commission, from which the carrier had no appeal. The amount determined by the Interstate Commerce Commission was certified to the Secretary of the Treasury who was charged with the duty of paying such amount.

On April 12th, 1923, the Interstate Commerce Commission, by letter, notified the Cimarron and Northwestern Railway Company that there was nothing due it under Section 204. Nothing was accrued and nothing could have been accrued as payable to the carrier up to this time. (Finding 4 of the Court, R. 13.)

On June 28th, 1923, the Railroad and the Director-General made a final settlement. (Finding 4 of the Court, R. 12.) Any liability of the Government to the railroad would have been adjusted in that settlement and any accrual in 1920 would have been taken into consideration. Not until October 13, 1923, did the Interstate Commerce Commission determine an amount payable to the railroad and certify such amount to the Secretary of the Treasury for payment. *Then and only then could the railroad have accrued on its books an amount due it. U. S.* v. *Anderson*, 46 S. Ct. 131; 269 U. S. 422.

It might be argued that all of the factors were known in 1920 from which the amount due the railroad could have been determined, but the facts indicate otherwise. One accountant for the Interstate Commerce Commission determined that the railroad was entitled to $42,594.76. Following this the Bureau of Finance of the Interstate Commerce Commission determined that there was nothing due to the carrier. However, by re-determining various costs and factors (which was entirely within its own prerogative and power) the Interstate Commerce

Commission finally reached a determination on October 13, 1923. (See Finding of Fact No. 4 of the Court, R. 4–6.) Thus even an approximate accrual before this date would have been impossible. In its argument upon this point before the Court of Claims, petitioner relied upon the decision of this Honorable Court in *Lucas* v. *American Code Company, Inc.*, 50 S. Ct. 202, 280 U. S. 445. The Court of Claims, in its opinion, held that the American Code Company decision is not in point, and said (R. 21):

> "Furthermore, the plaintiff in American Code Company was not a common carrier subject to Interstate Commerce Regulations which prescribe its method of accounting."

But the Cimarron and Northwestern Railway Company *is a common carrier and its method of accounting is prescribed by the Interstate Commerce Commission.* It is not believed that the Interstate Commerce Commission would require the Cimarron and Northwestern Railway Company to accrue in 1920 a payment under Section 204 of the Transportation Act, *when the Interstate Commerce Commission itself had not, in 1920, even begun to determine whether there was any amount payable or not.*

Petitioner insists that the principles enunciated in the *American Code Company* case (*supra*) are controlling here, especially in view of the fact that the Cimarron and Northwestern Railway Company had no claim or right to any amount whatever until the Interstate Commerce Commission, which had exclusive jurisdiction of the matter, made its determination in 1923.

Wherefore, it is submitted that even if the payment to the Cimarron and Northwestern Railway Company under Section 204 of the Transportation Act is held to be taxable income, it was not income in 1920 and was not taxable until 1923, the year in which the determination was made and the amount was paid.

VII. CONCLUSION.

In view of the foregoing it is respectfully submitted that this Honorable Court should reverse and set aside the decision and judgment of the Court of Claims so far as it pertains to the item of $25,228.35 which was paid to the Cimarron and Northwestern Railway Company in 1923 under the provisions of Section 204 of the Transportation Act of 1920, and hold that such payment did not constitute taxable income to the recipient or, if it was taxable income, that it was returnable in the year 1923 when the amount was determined and paid.

Wherefore, it is respectfully submitted that this case is one calling for the exercise by this Court of its supervisory power, not only in order that the law may be correctly construed, but also in order that taxpayers generally may not be deprived of due process of law by the taking of their property through taxation and depriving them of the rights of judicial determination and that to such an end a writ of certiorari should be granted and this Court should review the decision of the Court of Claims and finally reverse it as above stated.

Respectfully submitted,

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APPENDIX.

Excerpts from the Revenue Act of 1918:

"Sec. 213. That for the purposes of this title * * * the term 'gross income'—

"(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of Section 212, any such amounts are to be properly accounted for as of a different period; but

"(b) Does not include the following items, which shall be exempt from taxation under this title:

* * * * * * * * *

"(3) The value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included in gross income); * * *."

Excerpts from the Transportation Act of 1920:

"Sec. 204. (a) When used in this section—

"The term 'carrier' means a carrier by railroad which, during any part of the period of Federal control, engaged as a common carrier in general transportation, and competed for traffic, or connected, with a railroad under Federal control, and which sustained a deficit in its railway operating income for that portion (as a whole) of the period of Federal control during which it operated its own railroad or system of transportation; but does not include any street or interurban electric railway which has as its principal source of operating

revenue urban, suburban, or interurban passenger traffic or sale of power, heat, and light, or both; and

"The term 'test period' means the three years ending June 30, 1917.

"(b) For the purposes of this section—

"Railway operating income or any deficit therein for the period of Federal control shall be computed in a manner similar to that provided in section 209 with respect to such income or deficit for the guaranty period; and

"Railway operating income or any deficit therein for the test period shall be computed in the manner provided in section 1 of the Federal Control Act.

"(c) As soon as practicable after March 1, 1920, the Commission shall ascertain for every carrier, for every month of the period of Federal control during which its railroad or system of transportation was not under Federal operation, its deficit in railway operating income, if any, and its railway operating income, if any (hereinafter called 'Federal control return'), and the average of its deficit in railway operating income, if any, and of its railway operating income, if any, for the three corresponding months of the test period taken together (hereinafter called 'test period return'): *Provided*, That 'test period return' in the case of a carrier which operated its railroad or system of transportation for at least one year during, but not for the whole of, the test period, means its railway operating income, or the deficit therein, for the corresponding month during the test period, or the average thereof for the corresponding months during the test period taken together, during which the carrier operated its railroad or system of transportation.

"(d) For every month of the period of Federal control during which the railroad or system of transportation of the carrier was not under Federal operation, the Commission shall then ascertain (1) the difference between its Federal control return, if a deficit, and its test period return, if a smaller deficit, or (2) the difference between its test period return, if an income, and its Federal control return, if a smaller income, or (3) the sum of its Federal control return, if a deficit, plus its test period return, if an income. The sum of such amounts shall be credited to the carrier.

"(e) For every such month the Commission shall then ascertain (1) the difference between the carrier's Federal control return, if an income, and its test period return, if a smaller income, or (2) the difference between its test period

return, if a deficit, and its Federal control return, if a smaller deficit, or (3) the sum of its Federal control return, if an income, plus its test period return, if a deficit. The sum of such amounts shall be credited to the United States.

"(f) If the sum of the amounts so credited to the carrier under subdivision (d) exceeds the sum of the amounts so credited to the United States under subdivision (e), the difference shall be payable to the carrier. In the case of a carrier which operated its railroad or system of transportation for less than a year during, or for none of, the test period, the foregoing computations shall not be used, but there shall be payable to such carrier its deficit in railway operating income for that portion (as a whole) of the period of Federal control during which it operated its own railroad or system of transportation.

"(g) The Commission shall promptly certify to the Secretary of the Treasury the several amounts payable to carriers under paragraph (f). The Secretary of the Treasury is hereby authorized and directed thereupon to draw warrants in favor of each such carrier upon the Treasury of the United States for the amount shown in such certificate as payable thereto. An amount sufficient to pay such warrants is hereby appropriated out of any money in the Treasury not otherwise appropriated."